EU Law: Deterring Energy Investments and a Source of Friction

Ana Stanič

I. Overview

The European Union (“EU”) considers ensuring safe, secure, sustainable and affordable energy as key to our continued prosperity.1) Investments of more than € 1 trillion are needed by 2020 to modernise and expand Europe’s energy infrastructure, provide for increasing and changing demand, interconnect networks across borders and integrate electricity from renewable sources.2) Much of that investment will need to come from outside the EU.

This article examines three key ways in which EU energy law undermines much-needed investment in the energy sector and why it is fast becoming a source of friction between the EU and investors from non-EU countries. First, Section II discusses the new powers accorded to the EU under the Lisbon Treaty in the fields of energy and foreign direct investment (“FDI”), the recent energy-related legislation adopted by the European Commission (the “EC”) invoking such powers and the uncertainty which now hangs over existing and future investments in the energy sector as a result. Second, the fraught relationship between EU law and International Investment law is examined in Section III by contrasting the positions taken by the EC, arbitral tribunals and the Court of Justice of the European Union3) (the “Court”) and in turn analysing the implications this conflict has on energy investments. Third, Section IV discusses the uncertainty regarding the enforcement of arbitral awards in cases where EU law is the applicable law by

---


3) Prior to the entry into force of the Lisbon Treaty, the Court was known as the European Court of Justice thereafter its name changed to the Court of Justice of the European Union.
reviewing the reasoning of the arbitral tribunal in the *Electrabel S.A. v. Republic of Hungary* (the “Electrabel Case”)
\(^4\), the Court’s decisions regarding the mandatory nature of certain provisions of EU law and the recent attempt by the EC to prevent the enforcement of an ICSID arbitral award.

II. Lisbon Treaty Accords the EU New Powers

The EU was granted express competence in the fields of energy and FDI for the first time in the Lisbon Treaty in 2009.\(^5\) With respect to energy, Article 4.2(e) Treaty on the Functioning of the European Union (“TFEU”) provides that the EU and Member States (“MS”) share competence in the field of energy.\(^6\) Anchoring the EU’s competence in energy in the context of the establishment and functioning of the internal market and the need to preserve and improve the environment\(^7\), Article 194 (1) provides that “Union policy on energy shall aim ... to: (a) ensure the functioning of the energy market; (b) ensure security of energy supply in the Union; (c) promote energy efficiency and energy saving and the development of new and renewable forms of energy; and (d) promote the interconnection of energy networks”\(^8\)

The EU maintains that Article 3(1)(e) TFEU when read in conjunction with Articles 206 and 207 TFEU accords it exclusive competence in respect of FDI. Article 3.1(e) provides that the EU has exclusive competence in the area of “common commercial policy”. Articles 206 and 207 refer to the establishment of the customs union and grant competence to the EU to enter into agreements with non-EU states with respect to trade and FDI.

Invoking these new powers, the European Council at the Summit on 4 February 2011 called for the Europeanisation of energy policy and signalled a new


\(^7\) Prior to the adoption of the Lisbon Treaty the EC had relied on its competences in the field of environment and the internal market to adopt legislation in the field of energy including the three legislative packages on the establishment of the internal electricity and gas market and the regulation on gas security. Although Article 194 makes reference only to these competences as the basis for the adoption of EU energy policy, there is no doubt that the EC considers, and MS have not opposed this, that its competences are now broader.

\(^8\) *Ibid.* Although paragraph (2) of Article 194 guarantees that a MS retain the sovereign “right to determine the conditions for exploiting its energy resources, its choice between different energy sources and the general structure of its energy supply” this guarantee has been significantly hollowed out since the adoption of the Lisbon Treaty.
and more robust EU energy policy going forward. It also called for greater coordination and coherence in the EU’s external energy policy and relations to ensure that MS act for the benefit of the EU as a whole in their bilateral energy relations with key EU partners as well as during multilateral negotiations concerning energy matters.

This Summit marked a watershed in EU energy policy. Having been invited by the European Council at the Summit to use these new powers, the EU adopted two significant legislative acts in 2012: (i) the Decision 994/2012/EU establishing an information exchange mechanism with regard to intergovernmental agreements between Member States and third countries in the field of energy (the “Decision”) and (ii) the Regulation 1219/2012 establishing transitional arrangements for bilateral investment agreements between Member States and third countries (the “Regulation”).

The key provisions of these legislative acts and the powers accorded to the EC thereunder are outlined in turn below.

A. The Decision Grants the EC Power to Review Existing and Future IGAs in the Field of Energy

Going well beyond the title of the Decision, Article 3(1) of the Decision imposed an obligation on MS to submit to the EC by 17 February 2013 all existing inter-governmental agreements (“IGAs”) they had entered into with non-EU countries in the field of energy for assessment of their compatibility with EU law. The obligation extended to all other agreements, including host government agreements typically entered into between an energy company and the MS in respect of a large energy investment, which were referred to in the IGAs if they “contain elements which have an impact on the functioning of the internal energy market or on the security of energy supply in the [EU].” As a concession to energy companies, the Decision expressly provided that agreements between private entities do not have to be disclosed.

Going forward, Article 3(3) of the Decision requires MS to submit all newly ratified IGAs in the field of energy to the EC for an assessment of their compatibility with EU law. MS are not required to notify the EC of the commencement of negotiations of IGAs with non-EU states, however, they run the risk that a ratified IGAs in the field of energy to the EC for an assessment of their compatibility with EU law. MS are not required to notify the EC of the commencement of negotiations of IGAs with non-EU states, however, they run the risk that a ratified


12) Also known as project support agreements.

13) See penultimate sentence of Article 3(1), supra note 10.
IGA will be considered by the EC as incompatible with EU law. For this reason it is likely that MS will exercise the option granted to them under Article 6(3) of the Decision of obtaining an opinion from the EC about the compatibility of an IGA with EU law while the negotiations are ongoing.

B. The Regulation Introduces Transitional Arrangements Regarding Existing Bilateral Investment Treaties with Non-EU States

Referring to Article 3.1(e) TFEU, the Regulation confirms that going forward as a general rule it will be the EU that will conclude bilateral investment treaties ("BITs") and free trade agreements ("FTAs") with non-EU states. Accordingly, Article 7 provides for a system whereby MS wishing to enter into negotiations to "amend an existing or to conclude a new bilateral investment agreement" with a non-EU MS must be authorised to do so by the EC. The conditions under which the EC will grant authorisation are set out in Articles 8 to 11 of the Regulation.14)

Article 2 imposes an obligation on MS to inform the EC of all BITs and other agreements that accord investment protection and into which they had entered into before 1 December 2009.15) Although the Regulation does not expressly grant the EC the power to review such BITs to ensure compatibility with EU law as is the case with the Decision, there is little doubt that the EC will undertake such review since it has the power to do so under Article 258 TFEU.16)

Finally, the Regulation also makes clear that BITs entered into by MS with non-EU states (known as extra-EU BITs) "will be progressively replaced by agreements of the Union relating to the same subject matter".17)

14) For a good discussion on whether this grandfathering Regulation was a legal “necessity” as claimed by the EC see Nikos Lavranos, In Defence of Member States’ BITs Gold Standard: The Regulation 1219/2012 Establishing a Transitional Regime for Existing Extra-EU BITs – A Member State’s Perspective, Transnational Dispute Management, 2 (2013).

15) December 1, 2009 was presumably chosen as the cut-off date since it is the date the Lisbon Treaty entered into force. The EC maintains it had exclusive competence in the field of FDI since then.

16) Even before the adoption of the Regulation the EC brought infringement proceedings pursuant to Article 258 TFEU against Finland, Sweden and Austria before the Court. In 2006 and 2007 the EC alleged that the provisions concerning the free transfer of capital contained in the BITs which these countries had entered into with non-EU states breached EU law. The Court found that the states were in breach and ordered them to take steps to remedy the breach by renegotiating the terms of the relevant BITs. See Commission of the European Communities v. Republic of Finland, ECR–10889 (ECJ 2009, C-118/07); Commission of the European Communities v. Kingdom of Sweden, ECR I–01335 (ECJ 2009, C-249/06); and Commission of the European Communities v. Republic of Austria, ECR I–01301 (ECJ 2009, C-205/06).

17) See recital 5 to the Regulation, supra note 11.
C. Implications for Existing and Future Energy Investments

The Decision and the Regulation have significant implications for existing and future energy projects. First, the failure of the EC to make the findings of its review of the compatibility of IGAs under the Decision public, even though the study was completed almost a year ago, means that there is uncertainty hanging over agreements concerning important infrastructure and energy supply contracts in the EU. Second, the fact that the EC has even embarked on the task of reviewing the compatibility of agreements that were entered into before the Lisbon Treaty entered into force and in some cases before MS acceded to the EU undermines the legal certainty and stability of the investment framework within the EU. Third, it has further strained the already fraught relations between EU law and international investment law, as discussed in Section III below. Fourth, a determination by the EC of an IGA’s incompatibility will put MS in a difficult position where their compliance with EU law will mean that they will be in breach of the terms of the respective IGAs and may result in their breach of the provisions of the Energy Charter Treaty (“ECT”) and any applicable BIT.

The EC has already made determinations as to incompatibilities under the Decision. In August 2013 the EC notified a number of Central and Eastern European countries that their IGAs with Russia relating to the South Stream pipeline project were incompatible with EU law. The EC started infringement proceedings against Bulgaria in June this year alleging that its South Stream IGAs breach provisions of EU law. It is possible that proceedings will be started against other MS in due course.

The fact that the EC has to date directed its actions against South Stream IGAs only has led many to dismiss the above-mentioned concerns as alarmist. However, there is no reason to think that these were one-off actions against South Stream. The fact that the EC had successfully challenged free transfer provisions of BITs which Austria, Sweden and Finland entered into with non-EU countries in the Court even before it was accorded these new powers under the Lisbon Treaty suggests that it is likely that it will use its powers robustly going forward. It is not yet clear which other provisions of the BITs it will consider incompatible with EU law, but given the discussion in Section III it is possible that it will even...
consider provisions concerning fair and equitable treatment as incompatible. This uncertainty over the EU’s investment framework combined with growing uncertainty, about the EU’s readiness to comply with its, and/or allow MS to comply with their obligations under the ECT\(^2\), BITs and international law in general is likely to deter investment in energy infrastructure, from both within and outside the EU.\(^2\)

III. EU Law and International Investment Law: Friends or Foes?

EU MS are parties to over 190 intra-EU BITs and more than 1200 extra-EU BITs.\(^2\)\(^5\) They are also parties to the ECT as is the EU itself. The key rights accorded to investors under the ECT and BIT’s are: (i) the right to fair and equitable treatment ("FET"); (ii) the right to national treatment, being the right to treatment no less favourable than that which the MS/EU accords to its own investors; (iii) the right to most favoured nation treatment, being the right to treatment no less favourable than that is accorded by MS/EU to investors from other states; (iv) the right to compensation in case of expropriation and nationalisation or an act tantamount to expropriation or nationalisation; and (v) the right to commence arbitration in case of a breach of the above-mentioned rights.

There has been much debate on whether EU law accords investors the same protection as is accorded to them under the BITs, the ECT and international law in general. In recent investment treaty arbitrations brought against MS, including in the field of energy, the EC has insisted that it does, as have a number of MS.\(^2\)\(^6\)

However, arbitral tribunals in most publicly available investment treaty arbitrations have correctly taken a different view as has the Court in its decision in the

---

\(^2\) In March 2014 the EC issued a decision prohibiting Romanian courts from enforcing an ICSID Arbitral Award. See European Commission, DG Competition Decision SA.38517; Micula v. Romania ICSID arbitration award, (2014/C) (March 26, 2014). On September 2, 2014 Micula brought a case challenging the decision of EC before the Court. See Micula and Others v. Commission (Case T-646/14) (the "Micula Case"). See further discussion in Section IV (c).

\(^2\)\(^4\) The EC has also taken a very aggressive stance against BITs entered into between EU MS (known as intra-EU BITs) describing them as “an anomaly within the EU internal market”. See Eureko B.V. v. The Slovak Republic, PCA Case No. 2008-13, Award on Jurisdiction, Arbitrability and Suspension, Oct. 26, 2010, at para. 177 (the “Eureko Case”).

\(^2\)\(^5\) European Commission, EU Agrees Rules to Manage Investor-state Disputes, available at trade.ec.europa.eu/doclib/press/index.cfm?id=1151, last accessed on November 1, 2014. The term “intra-EU BITs” is used to describes BITs entered into between two EU MS, whereas the term “extra-EU BITs” described BITs entered into by an EU MS with a non-EU MS.

\(^2\)\(^6\) See for example Eureko Case, supra note 24 at para. 69 and Electrabel Case, supra note 4, at paras. 4.104-4.106.
European Commission v. Slovak Republic (the “Slovakia Case”). The approaches taken by the Tribunal in the Eureka Case and the Court in the Slovakia Case are examined in turn.

A. The Approach Taken by the Tribunal in the Eureka Case

The Eureka Case concerned an investment by a Dutch company in the Slovak health insurance sector. Eureka alleged that the systematic reversal of the 2004 liberalisation of the sector which had prompted it to make an investment in the sector amounted to inter alia (i) a breach of FET; and (ii) expropriation. The Tribunal therefore had to examine the nature of the rights accorded to investors under EU law and the BIT. It held that “the protections afforded to investors by the BIT are, at least potentially, broader than those available under EU law (or, indeed, under the laws of any EU Member State)”.

It produced the following table in para. 247 of its award comparing the rights accorded to investors under EU and international law.

<table>
<thead>
<tr>
<th>BIT</th>
<th>EU Law</th>
</tr>
</thead>
<tbody>
<tr>
<td>Free transfer of capital</td>
<td>Free movement of capital</td>
</tr>
<tr>
<td>Fair and equitable treatment</td>
<td>Prohibition of discrimination</td>
</tr>
<tr>
<td>Indirect expropriation</td>
<td>Freedom of establishment</td>
</tr>
<tr>
<td>Full security and protection</td>
<td>Freedom of establishment</td>
</tr>
<tr>
<td>Arbitration Clause</td>
<td>Damage claim against the state before national courts</td>
</tr>
</tbody>
</table>

In respect of the FET standard accorded to investors under BITs the Tribunal in the Eureka Case observed that no “such principle, independent of concepts of non-discrimination, proportionality, legitimate expectation and of procedural fairness, is yet established in EU law”.23)

28) See Eureka Case, supra note 24, at para. 245. Similarly in para. 159 of its award in the Eastern Sugar B.V. v. Czech Republic SCC Case No. 088/2004, Partial Award (UNCITRAL, March 27, 2007) the Tribunal noted that it “did not accept the submission of the Czech Republic that the EU treaty cover[ed] the same subject matter as the BIT”.
29) See Article 63 and 65 TFEU.
30) See Article 18 TFEU.
31) See Article 49 TFEU.
32) In addition to the right of an investor to bring claims in national courts for breaches of EU law, an investor has a right, pursuant to Article 263 TFEU, to commence proceedings against EU institutions for breaches of EU law before the Court. The Court’s case law based on the Francovich decision confirms the liability of MS and the EU for damages resulting from the violation of EU law. See Francovich, ECR I-5357 (ECJ 1991, Joined Cases C-6/90 and C-9/90); Brasserie du Pêcheur and Factortame III, ECR I-1029, (ECJ 1996, Joined Cases C-46 and C-48/93); and Courage, ECR I-6297 (ECJ 2001, Case C-453/99).
33) Supra note 24, at para. 250.
The following comparison of the reasoning adopted by the Court in *Vereniging voor Energie, Milieu en Water and Others v. Directeur van de Dienst uitvoering en toezicht energie* (the “VEMW Case”)[34] with the usual approach taken by tribunals in investment treaty arbitrations in respect of FET confirms the correctness of the Tribunal’s conclusion.

The VEMW Case concerned contracts under which certain Dutch companies reserved a portion of capacity on the cross-border system for the importation of electricity into the Netherlands. At the time the contracts were concluded they fully complied with Dutch and EU law. In fact the preferential treatment regarding access to capacity granted under the contract was confirmed in the relevant Dutch law itself.[35] A number of years later, the first EU energy package was adopted prohibiting “[all discrimination] between system users or classes of system users” regarding allocation of capacity on electricity grids.[36]

In this case the Court was asked to determine whether preferential access was compatible with these provisions of the first energy package. In its analysis the Court noted that the non-discrimination requirement as set out in the Directive was a “specific expression[s] of the general principle of equality”[37] under EU law. It went on to observe that the Netherlands had not sought permission to derogate from Articles 7(5) and 16 respectively as permitted by the transitional regime contained in Article 24 of the Directive 96/92[38] and that no other derogation was permitted under it[39]. It concluded that, although the principle of the protection of legitimate expectations was “one of the fundamental principles of EU law”, it could not be invoked by a “prudent and circumspect trader [who] could have foreseen that the adoption of a Community measure is likely to affect his interests”.[40] In other words, the Court found that companies that sought access to the transmission network in the Netherlands could not be denied access on account of the preferential treatment accorded under the contracts and that priority – access was not enforceable under EU law. How an electricity company was expected to have foreseen this when even the Dutch law at the time the contracts were entered into expressly permitted such preferential treatment was not discussed by the Court. This reasoning contrasts starkly with the approach taken by arbitral tribunals in investment treaty cases. For example, the tribunal in *Técnicas Medioambientales Tecmed, S.A. v. Mexico* held that FET requires a state “not to affect the

35) *Id.*, at paras. 25–26 and 79.
37) *Id.*, at para. 47.
38) *Id.*, at paras. 59–60.
39) *Id.*, at paras. 61–63.
40) *Id.* at para. 74.
basic expectations that were taken into account by the foreign investor to make the investment.\textsuperscript{41)}

Turning to the protection accorded to investors against expropriation, the Tribunal in the \textit{Eureko Case} observed that this right was "by no means covered by the EU freedom of establishment. While it certainly overlaps with the right to property secured by Article 17 of the EU Charter of Fundamental Rights (and the First Protocol to the ECHR, as applied under EU law), the BIT provision on expropriation is not obviously co-extensive with it.\textsuperscript{42)}"

The Tribunal also noted that the right of an investor to commence arbitral proceedings against a MS and/or the EU for breaches of its rights under the BIT or ECT is not the same as the right to bring proceedings before national courts or the Court not least because of the difference in the interpretation of the investor’s substantive rights discussed above.\textsuperscript{43)}

\section*{B. The Approach Taken by the Court}

It came as a relief to many concerned by the anti-investment arbitration approach adopted by the EC when the Court in the \textit{Slovakia Case}\textsuperscript{44)} acknowledged that the rights accorded to investors under BITs and ECT are not the same as those under EU law. In a case factually similar to the VEMW Case, the Court held that Slovakia was not in breach of EU law for not declaring the contract\textsuperscript{45)} granting priority access to an electricity transmission line to a Swiss investor as invalid under EU law although such a contract potentially breached non-discrimination provisions of the second energy package.\textsuperscript{46)} The Court acknowledged that the preferential access granted to ATEL, the Swiss investor, under the contract was "a
monetary claim and right to any performance having an economic value” and accordingly, held that it was an “investment” pursuant to Article 1(2)(c) of the BIT between Slovakia and Switzerland.47) Relying on Article 351(1) TFEU the Court noted that in accordance with the principles of international law as set out in Article 30(4)(b) of the Vienna Convention on the Law of the Treaties, EU law does not “affect the duty of MS to respect the rights of non-member countries under agreements which these countries entered into prior to becoming members of the EU”.48) The Court further noted that the obligation imposed on EU MS under Article 351(2) TFEU “does not impose the obligation to achieve a specific result in the sense of requiring them, regardless of the legal consequences and political price, to eliminate the incompatibility”.49)

In what would seem to be a departure from its reasoning in VEMW Case the Court noted that: (i) Slovakia could not modify the terms or effects of the contract at issue by its legislation, or deprive that contract of legal effects50); (ii) even if Slovakia declared the privileged access to the transmission system invalid and inapplicable, SEPS would remain bound by the contract at issue51); and (iii) the only way for Slovakia to comply with its obligation would be to enact legislation which targeted SEPS, but that this would be tantamount to an indirect expropriation of ATEL’s right of transmission and accordingly a breach of BIT and ECT52). Accordingly, invoking Article 351 TFEU the Court concluded that Slovakia had not breached its obligation under EU law and, that in turn the right to priority access granted to ATEL under the contract was protected.

C. Implications for Energy Investments

The Court’s decision goes some way to clarify the inter-relationship between EU law and international law from the viewpoint of EU law. It clearly states that BITs into which MS entered before acceding to the EU will be honoured. By invoke-

40) Ana Stanič. Vision is a restatement of Article 7.5 of Directive 96/92/EC which was the basis for the claim in VEMW Case.
47) Supra note 27, at para. 37.
48) Id. at para. 41. Article 351(1) TFEU provides that “[t]he rights and obligations arising from agreements concluded before 1 January 1958 or, for acceding States, before the date of their accession, between one or more Member States on the one hand, and one or more third countries on the other, shall not be affected by the provisions of the Treaties”.
49) Id. at para. 44, confirming its judgment in Commission v. Portugal, ECR I-5171 (ECJ 2000, C-62/98) at para. 24. Article 351(2) provides that “[t]o the extent that such agreements are not compatible with the Treaties, the Member State or States concerned shall take all appropriate steps to eliminate the incompatibilities established. Member States shall, where necessary, assist each other to this end and shall, where appropriate, adopt a common attitude”.
50) Id. at para. 50.
51) Ibid.
52) Ibid.
ing Article 351 the Court avoided putting Slovakia in the difficult position where compliance with the decision of the Court would have resulted in it breaching its obligations under the BIT and ECT, potentially exposing it to a significant damages claim.

However, by relying solely on Article 351 the Court raises uncertainty about how it would approach a similar factual situation where the BIT had been entered into by the MS after it had acceded to the EU. Many BITs were entered into many decades ago. There was no suggestion that these BITs were incompatible with EU law until as recently as 2006. Since the Regulation was adopted in 2012, the EC has taken an even more anti-BIT approach. Presumably in such circumstances, the Court will find that EU law requires a MS to either, as a shareholder of the state-owned company that entered into the contract, to take steps to ensure that the contract is terminated or to pass a law invalidating the agreement. In such a situation the MS will find itself in the difficult situation Slovakia was able to avoid in the Slovakia Case.

Moreover, the only way one can reconcile the Court’s decision in the Slovakia Case with that in the VEMW Case is to conclude that the principle of legitimate expectation under EU law is not the same as the FET standard. As discussed above, it was the adoption of the same provision (albeit under different energy packages) that led the Court in the VEMW Case to conclude, applying EU law, that the terms and effects of the contract granting priority access were modified and, relying on the BIT, to conclude the exact opposite in the Slovakia Case. In other words, it held that a prudent investor could not invoke the principle of legitimate expectation to protect itself against changes in the law under EU law whereas it could do so by invoking the FET standard under the BIT and ECT.

In view of the above, it is clear that considerable uncertainty remains regarding the relationship between EU law and international investment law. The EC’s recent attempt to prevent Romania from complying with its obligations under Article 54 (1) of the International Convention on the Settlement of Disputes (the “ICSID Convention”) to enforce the arbitral award in the case of Ioan Micula, Viorel Micula, S.G. European Food S.A. et al v. Romania (the “Micula Award”)56)
has put further strain on this relationship and has created uncertainty regarding
the readiness of the EU to comply, and to allow MS to comply with their interna-
tional law obligations. Since under the ICSID Convention arbitral awards are au-
tomatically enforceable, the EC’s actions challenge the fundamental tenets of the
ICSID Convention and the whole basis for investment protection. Micula has
challenged the EC’s decision in the Court. Whatever the outcome of Micula’s
challenge, what is clear is that investors, whether within or outside the EU, face
considerable uncertainty as to whether their rights under BITs will be protected
under EU law and arbitral awards will be enforced by MS’s courts. This uncer-
tainty will undoubtedly deter future investments in the energy sector given their
long-term and capital-intensive nature.

IV. EU Law as Applicable Law – a Source of Uncertainty

Another area of uncertainty for investments in the energy sector concerns
EU law as the applicable law. As discussed below, this uncertainty relates to
whether (i) the fact that EU law is the applicable law is the basis for denying the ju-
risdiction of an investment treaty tribunal, (ii) EU law can be used as a defence to
avoid liability under a BIT and/or ECT, and (iii) EU law as a applicable law can be a
ground for refusing the enforcement of arbitral awards on the grounds of public
policy. These three issues will be examined in turn. The submissions made by the
EC and Hungary and the reasoning of the arbitral tribunal in the
Electrabel Case57) will serve as the starting point for exploring these issues.

The case concerned a claim by Electrabel, a Belgian company, against Hun-
gary58) for the alleged breach of its rights to FET and against expropriation under
the ECT. As such it was a claim by an investor from one MS in respect of an invest-
ment in another MS.

The key facts giving rise to the claim are as follows. MVM, a Hungarian state-
owned entity entered into a power purchase agreement (“PPA”) with Dunamenti,
a Hungarian generator, in October 1995 under which the capacity fee payable was
initially fixed until 2010 and then subsequently extended to 2015. As part of the
Hungarian government’s privatization of the energy sector, Electrabel acquired

57) Supra note 4.
58) Given the reasoning of the tribunal in this case it was a fatal error that Electrabel
had not brought proceedings against the EU as well as Hungary under the ECT. The tribunal
held that “[w]here Hungary is required to act in compliance with a legally binding decision of
an EU institution … [this] cannot (by itself) entail international responsibility for [it]. Under
international law, Hungary can be responsible only for its own wrongful acts. The Tribunal
considers that it would be absurd if Hungary could be liable under the ECT for doing pre-
cisely that which it was ordered to do by a supranational authority whose decisions the ECT
itself recognises as legally binding on Hungary”. Id., para. 6.72.
shares in Dunamenti in the period from 1995 to 2001. A year after Hungary joined the EU in 2004, the EC started investigating whether the PPA amounted to state aid. Having come under significant public pressure domestically to reduce prices, the Hungarian government reintroduced regulated electricity prices in 2006. In 2008 the EC issued a decision that the payments made under the PPA amounted to state aid and as such breached Article 107 TFEU. In light of the EC’s decision, the Hungarian Parliament decided that the PPA should be terminated with effect from January 1, 2009.59)

59) Supra note 4, at paras. 6.4–6.7.

The following were Electrabel’s key submissions to the arbitral tribunal. First, that the PPA was lawful when it had been entered into in 1995. Second, that Hungary could not rely on its internal law to justify a breach of international law. Third, that the termination of the PPA amounted to a breach of FET as per Article 10.1 of the ECT and an expropriation as per Article 13 of the ECT. Fourth, that the change in capacity pricing under the PPA also amounted to breach of FET and expropriation under the ECT.

A. EU Law as a Basis for Denying Jurisdiction of Arbitral Tribunals

The first source of uncertainty for investors is whether EU law is a basis for denying a tribunal jurisdiction under a BIT and/or ECT. In the Electrabel Case, as in the Eureko Case, the EC and Hungary sought to deny the Tribunal’s jurisdiction on the basis that EU law was the applicable law. In its amicus curia brief the EC argued that the Court has exclusive competence to determine issues of EU law. Invoking the decision of the Court in the Commission of the European Communities v. Ireland60) (the “Mox Plant Case”), the EC argued that in the EU judicial system the Luxembourg courts have exclusive jurisdiction (i) to determine whether MS have fulfilled their EU law obligations, and (ii) to give preliminary rulings on questions of EU law as requested by EU domestic courts and tribunals and that consequently, the Court has exclusive competence to determine issues of EU law61).

60) Commission of the European Communities v. Ireland, ECR I-04635 (ECJ 2006, C-459/03). The Mox Plant Case concerned infringement proceedings which EC brought against Ireland for commencing arbitral proceedings against the UK pursuant to the Convention for the Protection of the Marine Environment of the North-East Atlantic (the “OSPAR Convention”) and under United Nations Convention on the Law of the Sea (“UNCLOS”). Ireland brought claims under the two conventions against the UK for inter alia failing to carry out a proper environmental impact assessment and for failing to consult it in respect of the same in relation to the construction of a spent fuel reprocessing facility known as the Mox Plant in Sellafield in the UK. See OSPAR Convention, 2354 UNTS 67; 32 ILM 1261 (1982).

61) Supra note 4 at para. 5.20 (quoting from paragraphs 65–68 of EC’s amicus curia brief).
However, this reasoning is flawed from the EU law point of view. First, the EC wrongly relied on the *Mox Plant Case* since this case concerned a dispute between two MS and not a dispute between an investor and a MS. Second, although under Article 344 TFEU MS are obliged “not to submit a dispute concerning the interpretation or application of the Treaties to any method of settlement other than those provided for therein”62) this obligation applies *inter se* and does not oblige investors to resolve their disputes with MS in the Court (nor could it). In any event, it is unclear what relevance the Court’s decisions have in determining the jurisdiction of an international tribunal under an international investment treaty.63) As in the *Eureko Case*, the Tribunal in the *Electrabel Case* rejected the EC’s submissions and confirmed that it had jurisdiction to determine issues of EU law.64)

**B. EU Law as Applicable Law in Investment Treaty Claims**

The second source of uncertainty for investors concerns whether EU law can be invoked as a defence for a breach of BIT and/or ECT. In the *Electrabel Case* submissions were made by both parties and the EC on whether EU law was relevant to determining whether Hungary had breached its obligations under the ECT. In other words, the parties agreed that EU law was relevant for the determination of the merits of the case.

Since the parties to the case agreed that Article 42(1) of the ICSID Convention65) permitted parties a choice of law as the first step in its analysis the Tribunal turned to Article 26(6) of the ECT which provides that: “[a] tribunal established under paragraph (4) shall decide the issues in dispute in accordance with this Treaty and applicable rules and principles of international law”.66) The parties, however, had different views on whether EU law constituted “applicable rules and principles of international law”. Electrabel argued that Hungary’s action had to be assessed by reference to international law as set out in the ECT and that EU law, being Hungary’s internal law, was a question of fact only.67) Since the PPA was

---

62) *Supra* note 6.
63) *Supra* note 4, at para. 5.60.
64) *Supra* note 4, at para. 5.60.
65) Article 42(1) of the ICSID Convention provides that “[t]he Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable”.
66) *Supra* note 19.
67) *Supra* note 4, at para. 4.29.
lawful when it had been entered into in 1995 (before Hungary joined the EU), it argued, this meant that Hungary could not rely on changes in its internal law, arising as a result of EU law, to justify a breach of international law.  

Hungary, on the other hand, argued that “no logical reason exists to disregard the EC Treaty as an international treaty providing for rules of international law.” It further argued that in any event, EU competition law is part of international public order and therefore, termination of PPA cannot be treated as a violation of the ECT.

The Tribunal did not agree with the submissions of either party. It held that in respect of intra-EU cases EU law is part of international law as regional international law. In a surprising finding, the Tribunal concluded that EU law was both a question of fact and a question of law. It asserted that there is a special relationship between the EU and the ECT and that, consequently, if possible, the ECT should be interpreted “in harmony with EU law.” Ignoring the fact that the ECT contains no provisions regarding state aid, the Tribunal noted that due to this special relationship “[f]oreign investors in EU Member States, including Hungary, cannot have acquired any legitimate expectations that the ECT would necessarily shield their investments from the effects of EU law as regards anti-competitive conduct.” In any event, the Tribunal held that EU law on state aid is an EU mandatory rule and rule of international public policy and that, as such it overrode the provisions of the PPA.

This arbitral award has been subject to extensive criticism. Although it could be argued that most of the above-mentioned determinations, including equating the ECT with EU law are obiter dicta, there is no doubt that they ring alarm bells particularly with non-EU investors for the following reasons. First, the Tribunal seems to be saying that investments made by investors are denied protection which they would otherwise have under the ECT because the special relationship between the ECT and the TFEU means that the ECT should be read in harmony with EU law, thus permitting the EU and a MS to rely on changes in their law to avoid being in breach of the ECT. Second, since it considers state aid as a rule of international ordre public.

---

68) Id. at para. 4.39.
69) Id. at para. 4.66.
70) Id. at para. 4.68.
71) Id. at para. 4.122.
72) Id. at para. 4.130.
73) Id. at para. 4.141.
74) Id. at para. 4.189.
C. Mandatory Rules of EU Law and Enforcement of Arbitral Awards

The third area of uncertainty concerns the enforcement of international arbitral awards. As discussed above, the Tribunal in the Electrabel Case held that EU law on state aid was a mandatory provision of EU law and a provision of international *ordre public*. Assuming that the Tribunal conclusions are correct, the implications are two-fold. First, that under international law a MS is not in breach of its obligations under a BIT or the ECT for complying with a provision of international *ordre public*. Second, that the courts in a MS could, invoking the discretion accorded to them under Article V(2)(b) of the New York Convention, refuse to enforce an arbitral award which had not found that EU state aid was international *ordre public* and had consequently ordered damages against a MS or the EU.

The latter situation has arisen in respect of the enforcement of the Micula Award. On the grounds that the damages awarded by the ICSID tribunal constitute illegal state aid, the Commission issued a decision in March 2014 ordering the Romanian courts to refuse the enforcement of the award even though ICSID awards are automatically enforceable. As discussed above, Micula has brought a claim before the Court challenging the EC’s decision. Regardless of the Court’s decision, it is likely that, going forward, MS’ courts will refuse enforcement of arbitral awards on the ground of public policy, whether on the instruction of the EC or otherwise. As the review below of a few recent decisions of the Court shows, the Court has taken a very expansive approach when defining what a mandatory rule of EU law or EU *ordre public* is, to include, not only treaty provisions, but also provisions of regulations and even directives. Its broad approach contrasts with the approach taken by national courts of MS to date when enforcing international arbitral awards.

1. *Eco Swiss China Time Ltd v. Benetton International NV* (77)

The most well-known case on the inter-relationship between EU mandatory rules and arbitration is *Eco Swiss China Time Ltd v. Benetton International NV* (the “Eco Swiss Case”). In this case, the Court made clear that Article 101 TFEU is a mandatory rule of EU law and, as such, is a ground to refuse the enforcement of an arbitral award. Article 101 prohibits agreements and other concerted practices which may affect trade between MS and which have as their object or effect the prevention, restriction or distortion of competition within the internal market.78)

76) See supra note 23.
78) Article 101 TFEU provides:

> “1. The following shall be prohibited as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as
In its judgement the Court noted that “… Article [101] of the Treaty constitutes a fundamental provision which is essential for the accomplishment of the tasks entrusted to the Community and, in particular, for the functioning of the internal market.”\(^{79}\) The Court went on to say that “the provisions of Article [101] of the Treaty may be regarded as a matter of public policy within the meaning of the [1958] New York Convention”\(^{80}\) and concluded that “… a national court to which application is made for annulment of an arbitration award must grant that application if it considers that the award in question is in fact contrary to Article [101] of the Treaty …”\(^{81}\)

2. **Asturcom Telecomunicaciones SL v. Cristina Rodríguez Nogueira\(^{82}\)**

In this case the Court was asked to determine whether Article 6(1) of Council Directive 93/13/EEC on unfair terms in consumer contracts\(^{83}\) is a mandatory provision of EU law. Article 6(1) provides that “Member States shall lay down that unfair terms used in a contract concluded with a consumer by a seller or supplier shall, as provided for under their national law, not be binding on the consumer …”.

The Court held that it was a mandatory provision. In reaching its conclusions it observed that the Directive 93/13 “as a whole constitutes, in accordance with Article 3(1)(t) EC, a measure which is essential to the accomplishment of the tasks entrusted to the European Community and, in particular, to raising the standard of living and the quality of life throughout the Community. Accordingly, in view of the nature and importance of the public interest underlying the protection which [the] Directive … confers on consumers, Article 6 of the directive must be regarded as … [a rule] of public policy. It follows from this that, inasmuch as the...
national court or tribunal seized of an action for enforcement of a final arbitration
award is required, in accordance with domestic rules of procedure, to assess of its
own motion whether an arbitration clause is in conflict with domestic rules of
public policy, it is also obliged to assess of its own motion whether that clause is
unfair in the light of Article 6 of that Directive …”.


In the Ingmar Case the Court was asked to determine whether the rights
granted to commercial agents in case of the termination of contract as set out in
the Member States relating to self-employed commercial agents are mandatory,
even in respect of contracts which are governed by the law of a non-EU country.

Article 17 sets out circumstances in which the commercial agent is entitled,
on termination of the contract, to an indemnity or compensation for the damage
suffered as a result of the termination. Article 18 sets out the circumstances where
neither indemnity nor compensation is payable.

In its judgment the Court looked at the mandatory nature of the wording of
Article 19 of the Directive 86/653 which provided that “[t]he parties may not der-
ogate from Articles 17 and 18 to the detriment of the commercial agent before the
agency contract expires”. The Court noted that “[t]he purpose of the regime es-
tablished in Articles 17 to 19 of the Directive is thus to protect, for all commercial
agents, freedom of establishment and the operation of undistorted competition in
the internal market. Those provisions must therefore be observed throughout the
Community if those Treaty objectives are to be attained”. Accordingly, the
Court concluded that the terms of the above-mentioned Directive were manda-
tory and that such provisions overrode any contractual provision and the applica-
tible law chosen by the parties.

These cases show that the Court has to date adopted a very broad approach
when determining which provisions of EU law, whether found in the TFEU or di-
rectives, are mandatory provisions of EU law and EU ordre public. This contrast-
swith the approach adopted by MS’ courts to date when enforcing arbitral awards.
It would seem that the fact that at provision of EU law did not allow for derogation
or provided limited grounds for derogation was the basis for the Court’s finding
that even provisions of a directive are mandatory in nature.

84) Supra note 82, at paras. 51–53.
laws of the Member States relating to self-employed commercial agents (1986) OJ L 382 (the
87) Ibid.
88) Supra note 85, at para. 24.
D. Implications for Existing and Future Energy Investments

Recalling the wording of the provisions of the Directive 96/92/EC and Directive 2003/55/EC which the Court reviewed in the VEMW Case and the Slovakia Case respectively, it is possible, applying the reasoning of the Court in the above-mentioned cases, that these provisions, as well as many other provisions of the Third Energy Package ("TEP"); will be considered as mandatory by the Court and/or national courts of MS. If such an approach is taken by them, then many arbitral awards in the field of energy, particularly international investment awards, may be refused enforcement on public policy grounds. This additional uncertainty now surrounding the enforcement of energy related arbitral awards in the EU will undoubtedly deter investment in the energy sector, be it from within or outside the EU. Moreover, it will undoubtedly become a new source of friction between the EU and non-EU investors and the EU and its trading partners.

V. Conclusion

For the reasons discussed above, there are now considerable uncertainties regarding (a) the EU regulatory and investment framework; (b) EU law as applicable law in energy disputes; (c) the inter-relationship between EU and international investment law; and (d) the enforcement of arbitral awards within the EU.

Importantly, by undermining the international investment framework, the unilateralist approach taken by the EU evidenced by the adoption of the Regulation and the Decision; its submissions to arbitral tribunals contesting the jurisdiction of the tribunals to decide on EU law; and most recently in ordering Romania to refuse the enforcement of arbitral award on the grounds of public policy even when no such ground can be invoked under the ICSID Convention threatens the achievement of the very goals (discussed at the beginning of this article) which the EC set for its energy policy and which were the rationale for it being granted competences in FDI and energy under the Lisbon Treaty.

Since energy investments require large capital investment and are particularly vulnerable to political pressure, the purpose of the international investment framework is to provide a stable, comprehensive and non-discriminatory legal framework and reduce political risk. (90) Unfortunately, the way in which the EC


90) For example Article 2 of the ECT provides: “This Treaty establishes a legal framework in order to promote long-term cooperation in the energy field, based on complementarities and mutual benefits, in accordance with the objectives and principles of the Charter”.
has chosen to exercise its newly acquired competences under the Lisbon Treaty threatens the multi-lateral investment treaty framework which sought to depoliticise disputes relating to investments by providing for their resolution by international arbitration.

In May 2013, eight leading energy companies called on the EU to revitalise energy policy. In their open letter they noted that "[t]he lack of visibility and regulatory uncertainty will inevitably lead to an absence of energy investments with negative effects on security of supply, employment and reactivation of the European economy".91)

The explosion of investment treaty claims against MS for changes in energy law (particularly in the field of renewables) is indicative of how uncertain the investors consider the EU energy framework to be.92) To date no energy company has commenced an investment treaty claim against the EU but this is only a matter of time.

Claims are not only being brought by investors but also by states. In its recent claim against the EU before the WTO Dispute Settlement Panel,93) Russia has alleged that the provisions of TEP breach Articles of GATS, GATT, the Agreement on Subsidies and Countervailing Measures, the Agreement on Trade-Related Investment Measures and the Agreement Establishing the World Trade Organization.

This proliferation of claims may well be a taste of what is to come unless steps are taken by the EU to assure its trading partners that it will abide by the rules of international law that it and MS have played a key role in developing since the 1960s.

---

91) E.ON, Call of eight leading energy companies to EU leaders for a revitalized energy policy, Press release (May 22, 2013), available at www.eon.com/en/media/news/press-releases/2013/5/22/call-of-eight-leading-energy-companies-to-eu-leaders-for-a-revit.html, last accessed October 21, 2014. This joint statement was signed by the CEOs of the following eight European energy companies: Enel, Gasterra, GDF Suez, Iberdrola, Eni, RWE, E.ON, Gas Natural and Fenosa. See also Statoil, Well-functioning energy market key to Europe natural gas, Press release (April 4, 2014).

92) As of October 28, 2014 there were more than thirty-two ECT claims against MS recorded on the website of the ECT Secretariat. The ECT Secretariat is currently aware of more than fifty cases that have been brought to international arbitration against EU MS. Since there is no obligation on states to inform the ECT Secretariat of such claims, it is reasonable to expect that the number of actual claims under the ECT is higher. It is also likely that there is a significant number of claims brought against MS under BITs as well.

93) European Union and its Member States – Certain Measures relating to the Energy Sector, Request for consultations by the Russian Federation, WT/DS476/1 (April 30, 2014). Russia alleges that the EU has breached the following provisions of WTO Agreements: Articles 1 and 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes, Article XXIII of the General Agreement on Trade in Services ("GATS"), Article XXIII of the General Agreement on Tariffs and Trade 1994 ("GATT 1994"), Article 4.1, Article 7.1 and Article 30 of the Agreement on Subsidies and Countervailing Measures and Article 8 of the Agreement on Trade-Related Investment Measures.